KEYNOTE INTERVIEW

PE must pay attention to antitrust action

With the industry under increased scrutiny, sponsors must be more active on legislative and regulatory engagement, say Baker McKenzie's Michael Fieweger and John Fedele

In June 2022, the US Federal Trade Commission ordered JAB Consumer Partners to divest veterinary clinics as a condition of its proposed $1.1 billion acquisition of a competing clinic operator. The FTC also required prior approval and notice regarding JAB's future acquisitions in the same space. This was the first action since the US Department of Justice's antitrust unit declared PE buyouts were in its sights amid concerns roll-ups are detrimental to market competition. Baker McKenzie partners Michael Fieweger and John Fedele unpack what this action and the growing attention of antitrust regulators signal for private equity.

SPONSOR

BAKER MCKENZIE

Q Over the past year, we've seen declarations of increased scrutiny of PE from antitrust officials, particularly around roll-up strategies. How should buyout firms interpret these comments?

John Fedele: The FTC and DOJ are certainly interested and have a target on PE, rightly or wrongly, and they have the ability to look at non-reportable transactions. They are very interested in roll-up strategies that do not meet Hart-Scott-Rodino Act reporting thresholds. There has always been a risk, largely dependent on customer complaints, of non-reportable transactions being investigated, but that risk has grown.

What is particularly notable in the JAB consent decree is it includes a nationwide prior notice provision and also a broad prior approval provision. That is a risk if you have a roll-up strategy, because it then requires future notification on acquisitions in the same space. If you're in a competitive auction, that's going to put you at a disadvantage. I can envision a scenario where a PE firm has a long-term roll-up strategy, but

unexpectedly future acquisitions (even if below the HSR reporting thresholds) trigger an FTC review, which means future roll-ups are subject to this rather intense oversight going forward.

Q Are regulators considering ownership at the portfolio company platform, fund or firm level?

JF: If they are subject to a common manager, it's a fair assumption the agencies are going to take a broad view as to the aggregation of those market shares to a single entity when evaluating the competitive effects of a proposed transaction. There could be arguments against that – that the funds have different equity holdings and incentives – but be prepared for a view from the agencies that those shares should be aggregated because of the common management.

Michael Fieweger: In FTC chair Lina Khan's statement in the JAB settlement, she specifically refers to the fact JAB had been investing in clinics over a period of time, not just with respect to this particular platform, and that history of what they've deemed to be inappropriate and anti-competitive behaviour influenced the remedies in that case. The FTC and DOJ will look at how, historically, over the life of many funds, a firm has invested in these types of businesses and, as a result, they're going to look at that behaviour as a whole and presume the firm will be what they deem to be anti-competitive in their next investment.

Q That sounds like it could throw up some challenges for sector-focused funds. Which sectors are particularly in the crosshairs?

MF: Healthcare is a concern not only with respect to antitrust enforcement, but also with respect to the False Claims Act and other types of regulatory enforcement. By nature, these businesses deal with public payer and Medicare issues, so there are many ways they can get tied up with the government and be subject to regulation. As PE firms are looking at these types of businesses, they need to know this is on every regulator's radar.

There is a general view of this administration that private equity is bad for healthcare, for example, that it's anti-competitive and that PE firms are cost cutters, and that's all bad for the level of patient care. Private equity must get to grips with how it's going to manage that because the healthcare services sector is a focus of a lot of PE firms here in the US.

JF: My read of President Biden's executive order on promoting competition is that there's a real focus on industries directly impacting consumers – such as healthcare, agriculture, transportation – but that the mandate to address perceived harmful consolidation is even broader. There is a general sense across a variety of sectors that the agencies lack visibility into certain acquisitions that, in the aggregate, have reduced competition. As a result, smaller acquisitions that fall below the HSR reporting thresholds are an area ripe for enforcement action.

Q Is there any benefit to proactively reaching out to regulators ahead of a deal?

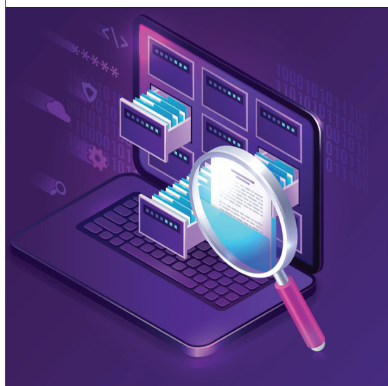
JF: If you have a transaction that's not reportable and doesn't require affirmative outreach, certainly it's an option to reach out, but there is a real risk in doing that. Part of the problem is that any ensuing investigation is not subject to the HSR Act's process and procedures (particularly with respect to any limits on the time for the FTC/DOJ to conduct their investigation), and so you could potentially be subjecting yourself to a lengthy review with no obvious end in sight, and timing is typically of the essence on any deal.

MF: As a buyer, you cannot be in a position to show sellers you pose this risk. Historically, PE has always been able to come into competitive auctions and say, 'We don't pose the same competitive risk as the other buyers, we're not in the market'. They regularly agreed to fairly strong hell or high-water covenants on what they would do to get the deal closed. It's not so certain these days that they aren't going to be scrutinised as a buyer, and their ability to agree to divestitures or to litigate potential enforcement action by any competition regulator, has lessened.

Q How can firms practically prepare for enhanced scrutiny?

Michael Fieweger: It's about doing due diligence ahead of time. Questions and analysis around competition law need to be undertaken at the beginning of the investment thesis, long before a firm is ever in an auction.

As firms are faced with potential reviews, they need to be able to show the investment thesis throughout their process, so when they need to disclose documents, diligence, and so on, those support a thesis that says, 'We are going to build this business, and we aren't buying just to cut people and investment'.



Historically, regulators just looked at market concentration issues; now, there are more nebulous claims that 'your activities as a private equity buyer may not be pro-competitive'. It's going to take people fighting these actions and winning them to rein in this aggressive antitrust enforcement position.

JF: There's also concern around ancillary investigations arising as part of the merger review, for example on employment or labour relations, or non-competes. The buyer does not want to get tied up in having to resolve an ancillary investigation just because of the deal it is trying to accomplish.

Q Do the agencies have the resources to follow up on these statements?

JF: The goal of the FTC and DOJ is to look at as many transactions as possible, but litigation is particularly resource-intensive, so at some point, there has to be a bottleneck. Because of the increased scrutiny transactions are receiving, we're seeing more instances in which firms have to withdraw their HSR notification to give the agencies more time to look at them. In the past, we would have assumed a transaction that presented limited competition issues might take 30 days to look at; now, it might take 60 days, maybe 90.

MF: Ultimately, the government is never resource constrained; it will expand resources via time. A typical HSR filing takes 30 days and if the regulator doesn't come back with a Second Request, you're good to go. Now the regulator says, 'Okay, you're going to pull and refile or I'm going to send you something, what do you want to do?'

More time kills deals, particularly in this environment, where the debt markets are challenging. Holding together a leveraged acquisition for longer than 60 days is difficult. The government knows it could scare people into compliance with its interpretation of antitrust law by bringing actions it might not be able to prevail on if it had to litigate, because the deal-making process cannot bear those costs, not only in terms of expensive litigation, but also in terms of time.

> *"PE firms must be cognisant they are under scrutiny globally"*
>
> **MICHAEL FIEWEGER**

Q What will the effect be on dealmaking activity?

MF: In the intermediate term, it is going to be chilling in certain strategies and certain industries. Longer term, we'll see where this all settles out. At this stage, we just don't know what's going to be enforced.

JF: Overall, private parties have done pretty well in litigation. You would think that would inform the agencies' future enforcement decisions, but I'm not sure that's going to happen. The change in the regulatory climate is not a result of changes in law, rather it is because of changes in policy and enforcement priorities, and those tend to move over time. In the short term, the courts have not moved in the same direction as the agencies, so there is that check. But it is not often companies are willing to sign up for litigation to prove the point. Litigation, ultimately, is unpredictable, it takes a long time and it's expensive, so not everybody is willing to sign up for that burden.

Q What should firms' top priorities be when it comes to antitrust issues going forward?

MF: PE firms must be cognisant they are under scrutiny globally, and they will need to pay the same attention to various regulators as companies that operate in industries that are under scrutiny. They need to be across what the regulatory landscape is with respect to those industries to a greater extent than has historically been the case. They've got to be more active with legislative and regulatory engagement and behave more like large corporates.

JF: PE firms should also be more discerning or creative in the transaction agreement and what they are agreeing to with respect to regulatory clearance. We are seeing more and more novel provisions in the risk-shifting section of a transaction agreement in reaction to the enforcement environment. One example is agreeing to hell or high-water covenants but with respect to only investigations immediately related to the transaction at hand as opposed to ancillary investigations, or being less willing to sign up for litigation.

In addition, implementing and adhering to robust HSR compliance programmes is imperative. The FTC and DOJ have flagged a concern that PE firms may not be complying fully with their HSR reporting obligations and that when they do make filings, they may not be producing all materials that are required under the relevant regulations. Given these statements, it seems reasonable to assume this will be an area ripe for investigations in the near future.

Similarly, firms should be aware of any risks related to interlocking directorates under Section 8 of the Clayton Act, which with limited exceptions prohibits executives from serving simultaneously on competitors' boards. The DOJ recently initiated a series of investigations under Section 8, with a particular emphasis on private equity firms with representatives on boards of competitors. ■